S&P Global
Ratings

RatingsDirect®

Ontario Teachers' Pension Plan Board

June 15, 2022

PRIMARY CONTACT

Jennifer Love, CFA
Toronto
1-416-507-3285
jennifer.love
@spglobal.com

SECONDARY CONTACT

Hector Cedano, CFA
Toronto
1-416-507-2536
hector.cedano
@spglobal.com

This report does not constitute a rating action.

Credit Highlights

Overview

Key strengths	Key risks
Strong returns, increasing assets, and good management continue to support Ontario Teachers' Pension Plan's (OTPP or the fund's) stand-alone credit profile (SACP).	Similar to peers, difficult economic and demographic trends will continue to challenge the fund as it strives to generate strong returns sufficient to meet pension obligations.
OTPP's low-to-moderate leverage, strong liquidity, and well-diversified portfolio also support the fund's credit profile.	
Although the fund is operationally independent from the Province of Ontario, we believe there is a moderate likelihood of it receiving extraordinary government support, if necessary.	

Despite the ongoing COVID-19 pandemic and uncertain economy, OTPP recorded another strong net return of 11.1% in 2021. The fund has experienced strong asset growth since the 1990s, with net returns propelling net assets to $241.6 billion at year-end 2021.

We believe the fund's returns demonstrate its good management and successful implementation of its strategy, which support its creditworthiness. OTPP's credit profile is further supported by low-to-moderate leverage, strong liquidity, and a well-diversified portfolio.

Like other pensions and pension fund investment managers, OTPP faces a competitive investment environment and ongoing economic uncertainty in which to deploy its increasing assets.

Outlook

The stable outlook reflects our expectation that OTPP will continue to realize good medium-term investment returns and preserve its strong net asset position during the next two years. Furthermore, we expect the fund will maintain its independence, and strong financial management and risk management systems. We do not expect any change in the relationship or level of support between OTPP and its sponsors.

Downside scenario

We could lower the ratings if we saw evidence of a material increase in risk appetite or erosion in the performance of risk management systems. This could include large investment losses, an increase in total liabilities relative to total assets exceeding 50%, a marked decline in liquid unencumbered assets relative to liabilities, or a sharp erosion of the plan's funded status. In addition, because we cap the ratings on OTPP at one rating category above those on its sponsor, a downgrade on the Province of Ontario would lead to a similar action on the fund. As well, we could equalize the ratings on the fund with those on Ontario if we saw evidence of increased provincial involvement (causing us to revise OTPP's link with the province to very strong) or negative provincial interference. We consider these scenarios unlikely during our two-year outlook horizon.

Upside scenario

We could raise our ratings on OTPP if we raised our rating on Ontario.

Rationale

The ratings on OTPP reflect the fund's SACP, which S&P Global Ratings assesses at 'aa+'. The ratings also reflect our opinion of a moderate likelihood that the Ontario government would provide extraordinary support in the event of financial distress. The SACP on OTPP reflects our assessment of the fund's strong financial and operating performance, strong fund management that includes a well-established and comprehensive enterprise risk management framework, and OTPP's independence from its sponsor (the Government of Ontario). We believe the difficult economic and demographic trends of recent years, particularly the negative effects of the pandemic, slower economic growth, low real yields, and increasing longevity, continue to offset some of these strengths.

Because we limit pension fund ratings to one full rating category above those on their sponsors, the credit quality of Ontario (A+/Stable/A-1) constrains the ratings on the fund.

OTPP is Canada's largest single-profession pension plan, with C$241.6 billion in net assets as of Dec. 31, 2021, which it invests on behalf of its two sponsors: the Ontario government and Ontario Teachers' Federation. In addition to managing the assets of the Ontario Teachers' Pension Plan, the fund manages its liabilities, administers the plan, and pays benefits. Since its establishment in 1990, OTPP has generated strong returns for plan members (9.7% net annualized return since inception to Dec. 31, 2021) and developed into a sophisticated long-term global investor. The fund's growing size has benefited from strong management, which has built out OTPP's investment capabilities as well as the fund's risk management in tandem with its assets' increasing size and complexity.

We view OTPP as independent of the Ontario government. The fund was established as a nonshare capital corporation and has legal ownership of plan assets. OTPP's independent board appoints senior management. The fund alone establishes policies for investments, asset allocation, and risk management; and develops and executes its own investment strategies. Independent actuaries effectively determine funding requirements and actuarial assumptions.

OTPP is a strong organization, with an experienced and skilled management team, in our view. Its independent management maintains a clear set of operating and funding principles and has designed an organizational structure that we believe is well aligned with the fund's performance goals. Investment strategies are consistent with the fund's expertise and funding needs, and management has a long track record of exceeding performance benchmarks. Internal controls are what we consider very robust, and include codes of conduct, segregation of duties, and a pre-trade clearance process, among many other safeguards. The enterprise risk framework is very strong, in our opinion, and includes several risk committees and a chief risk officer. Moreover, the fund's risk management practices are consistently evolving in line with OTPP's growth, investment activities, and complexity. We believe OTPP management demonstrates strong operational effectiveness and risk management.

The fund's operating and financial performances are strong, in our opinion. Despite the ongoing pandemic and continued economic uncertainty, OTPP generated an 11.1% net return in 2021, higher than its 4.5% discount rate. This was higher than its 8.8% benchmark return and the 8.6% net return recorded a year earlier. Private equities and natural resources posted notably strong positive returns in 2021; however, bonds and real rate products had negative returns of 9.4% and 1.4%, respectively. The fund is mature and made net payments of $3.6 billion in 2021; however, owing to investment returns, net assets continued to increase. Also in 2021, OTPP remained fully funded, while maintaining a conservative discount rate. The fund's total liabilities as a percent of total assets increased to about 26% in 2021 from about 21% in the previous year. Along with other pension funds, OTPP continues to face difficult demographic and economic trends. Long-term real interest rates have been low for several years, which has inflated the net present value of future long-term benefit obligations. Life expectancy has risen in the past decade, also increasing the net present value of benefit obligations. Furthermore, the fund is a mature plan whose payouts exceed contributions and the ratio of active-to-retired members is 1.2 to 1.

Ontario Teachers' Pension Plan Board -- Selected Ratios

	2021	2020	2019	2018	2017
UAAL (mil. C$)*	(15,900)	(36,089)	(17,257)	(1,169)	(14,844)
UAAL ratio (%)*	94%	86%	92%	99%	93%
Return on net investments (%)	11.3%	8.8%	10.8%	2.8%	9.9%
Return on assets (%)	7.3%	5.2%	6.2%	0.6%	5.3%
Return on net assets (%)	9.2%	6.7%	8.5%	0.9%	7.9%
Total margin (%)	72.5%	65.1%	69.6%	19.5%	68.3%
Pension benefit expense delivery efficiency (%)	89.4%	90.4%	90.3%	90.8%	91.9%
Pension benefit expense (% of Ontario's adjusted operating revenues)	1.1%	1.0%	1.0%	1.0%	1.1%
UAAL* (% of sponsor's budget**)	(1,064.51)	(2,433.36)	(1,177.13)	(81.62)	(1,054.90)
UAAL* per capita (C$)**	12.0%	15.2%	13.8%	37.7%	16.6%
Benefit contributions (% of total revenues)	5.9%	7.5%	6.8%	18.7%	8.2%

*Based on S&P Global Ratings' calculations. **Based on Ontario forecast for 2021. UAAL--Unfunded actuarial accrued liability.

In accordance with our government-related entity criteria, we view the likelihood of the fund receiving extraordinary government support as moderate, based on our assessment of the strong link with the province, which the government's joint stewardship of the plan and the provisions under the fund's enabling statute demonstrate. We believe OTPP's role is of limited importance to the government because it is a not-for-profit entity that could be replaced by another one without compromising the government's relationship with teachers, in our opinion. In addition, the fund's mandate is to provide pensions to a single profession and is one of many pension plans receiving money from the government.

We continue to rate OTPP above the province, based on our belief that the fund SACP is stronger than that of the province. We believe the government's willingness and ability to impair OTPP's creditworthiness in periods of stress is limited. Moreover, we believe the fund could effectively mitigate negative government intervention through its independence, effective governance structure, and legal ownership of plan assets. In addition, we believe OTPP's significant financial assets would be sufficient to allow the fund to meet its benefit obligations and debt service payments during periods of stress, including a Province of Ontario default.

Because OTPP unconditionally and irrevocably guarantees Ontario Teachers' Finance Trust's senior unsecured debt and commercial paper (CP) programs, we equalize the ratings on the debt and the programs with those on OTPP. In 2021, OTPP had about $2.5 billion in CP and $23.4 billion in term debt outstanding.

We have used our "Principles Of Credit Ratings" in conjunction with "USPF Criteria: Public Pension Funds" and "Rating Government-Related Entities: Methodology And Assumptions" as our criteria foundation for our analysis of OTPP's stand-alone creditworthiness. We believe there is sufficient similarity between U.S. and Canadian pension systems such that the U.S. pension fund criteria are an appropriate methodology for evaluating Canadian public pension funds' credit quality. We also use our "Methodology For Linking Long-Term And Short-Term Ratings" criteria as a basis to provide short-term ratings on the fund.

Liquidity

OTPP benefits from robust liquidity, in our view. The fund has a policy of maintaining a portfolio of highly liquid assets, including Canadian and U.S government bonds. It tracks its liquidity position daily and monitors liquidity via coverage ratios and stress testing. The fund held C$86.9 billion in level 1 fixed income assets and C$24.6 billion in level 1 equity at the end of 2021. According to OTPP's calculations, it held C$79 billion of available liquid assets to support fund liquidity as of Dec. 31, 2021. This well exceeds the total guaranteed debt outstanding of C$25.9 billion at year-end.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Governments | U.S. Public Finance: Public Pension Funds, June 27, 2007
- Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021

Related Research

- Province of Ontario, April 11, 2022
- S&P Global Ratings Definitions, Nov. 9, 2021

Ratings Detail (as of June 15, 2022)*

Ontario Teachers' Pension Plan Board	
Issuer Credit Rating	AA+/Stable/A-1+
Issuer Credit Ratings History	
17-Jun-2016	AA+/Stable/A-1+
17-Nov-2015	AA+/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.